

# Non-Traditional Mechanisms in Funding Transportation

## PRELIMINARY DRAFT FOR DISCUSSION ONLY

*This preliminary draft discussion paper is a work product developed by the consulting team for review and discussion by the Blue Ribbon Commission on Transportation. The contents are intended to provide the Commission members with factual background information and a balanced set of policy alternatives, including the pros and cons of these alternatives. This paper is one of a series and should be reviewed in the context of the entire series that, when taken together, presents a comprehensive overview of the state's transportation system.*

*This discussion paper series has been prepared primarily for Blue Ribbon Commission members new to these issues who wish to engage in a fundamental debate and for a more general audience of interested citizens who may wish to comment on the Commission's deliberations. This paper is intended to be provocative and to stimulate discussion of issues and options in funding transportation in this state. It questions the current ways of doing business, not for the sake of finding fault, but to allow consideration of other potential ways of thinking about basic funding issues that might be appropriate in the future.*

## INTRODUCTION

The Revenue Committee of the Blue Ribbon Commission on Transportation has been briefed on the parts of the existing transportation funding system. It has learned of the major tax sources available at the federal, state and local levels. Other discussion papers in this series have outlined issues and potential solutions relating to many of the existing major funding sources.

A broad look at the funding structure is provided in the discussion paper *Overview of Transportation Funding in Washington*; an overview of issues related to the motor fuel tax is provided in the paper, *The Distribution of Gas Tax to the State, Cities and Counties*. Local government revenues are discussed in *Local Sources of Funding City and County Transportation Needs*.

This paper turns its attention to non-traditional funding mechanisms that exist today and examines their characteristics, their benefits and feasibility issues that have prevented them from becoming more widely used. As used here, "non-traditional" refers to sources that are not in wide use in Washington today although they have been authorized in statute. Another broad category of funding mechanisms is discussed in a companion paper to this one, *Market Mechanisms and User Fees in Funding Transportation*. Non-traditional sources discussed in this paper are sources other than the gas tax, the motor vehicle excise tax (MVET), vehicle registration, permit and license fees, general property taxes, business taxes or sales taxes.

What does that leave? It leaves an assortment of funding tools that use any or all of the following features:

- Mechanisms that call on partnership with the private sector;
- Mechanisms that call on voluntary assessments or taxes for a special purpose; and
- Mechanisms that use debt financing in creative ways.

## ISSUE STATEMENT AND BACKGROUND

The traditional use of taxes and fees by state and local government to fund transportation in Washington appears in some ways to have reached a natural limit in the current environment. Public opposition to increased rates of existing taxes is reflected in surveys and polls and, most recently, in the certification of Initiative 695 which would repeal the state's Motor Vehicle Excise Tax. Yet at the same time, transportation officials have long lists of identified services and facilities that are needed to keep pace with deteriorating infrastructure and population and economic growth. Planners and public works officials are confronting increasing demand for roadway capacity, bus and rail service, bicycle lanes, parking lots, capacity for freight movement and numerous other kinds of improvements. Transportation departments at all levels of government find that there are insufficient funds to meet these needs.

### What other, non-traditional options exist to fund transportation needs?

Following are the mechanisms that are considered here:

- Local Improvement District/Road Improvement District (LID/RID)
- Transportation Benefit District (TBD)
- Tax Increment Financing
- Toll Road/Toll Bridge Authority
- 63-20 Financing and Industrial Development Bonds

These funding mechanisms share certain characteristics:

**Localized benefit.** They are localized in nature and fund a single project or a cluster of projects that benefit a specific geographic area, from a single block to potentially an entire county.

**Beneficiaries pay.** They tend to extract payment directly from those who benefit from the improvement, not from the general tax-paying public. Thus they depend on the willingness and ability of property owners or a subset of the public to pay for the improvement. Clearly, not all beneficiaries always perceive a benefit, or even if they do perceive a benefit, not all are willing to participate in paying for it.

**Use of debt financing.** They all rely on the use of debt financing and leverage time payments to help spread costs. Because payment for the improvement is spread out over many years, sometimes over several generations of users, it can be viewed as more equitable than imposing

the costs on a single group of users. Debt financing also, however, raises opposition from some who view it as too risky and prefer a conservative pay-as-you-go approach.

### **Benefits of Non-Traditional Funding Strategies**

**New revenues.** These sources raise new money outside of the existing taxes and fees. The new money is generally of only limited revenue potential, as it tends to depend on a very narrow tax base or beneficiary base. Nevertheless, it often provides funds where traditional sources would not and creates additional funding in an environment marked by long lists of unfunded needs.

**Perceived as equitable.** Since those who pay are also those who benefit, many of these sources share the character of user fees and are thus viewed as more fair than general purpose taxes. This is not always the case, however, as sometimes there are users who feel that their general purpose taxes should be paying for the proposed improvement, regardless of whether existing funds would ever be sufficient to do so.

**Speed and efficiency.** Non-traditional funding sources can sometimes considerably speed the implementation of locally desirable projects and thus reduce their costs. If project development is carried out by an entity other than government, then public procurement processes may be short circuited leading to some efficiencies.

### **Costs of Non-Traditional Funding Strategies**

**Implementation costs.** Most of these non-traditional approaches involve considerable costs to initiate and implement. Some of the costs include: special analyses of who benefits by an improvement; outreach or advocacy campaigns to persuade residents of the value of the improvement; requirements for special hearings and a special election; debt issuance costs; and tax collection costs for the duration of the repayment period.

**Public opposition.** If opposition, appeals or lawsuits must be dealt with, then costs can rise significantly and timelines can become difficult to predict. Opposition tends to arise when residents do not support an improvement or when they believe that the funding mechanism is unfair because citizens are already paying for transportation through other taxes.

### **Outline of Non-Traditional Mechanisms**

#### **Local Improvement Districts /Road Improvement Districts (LID/RID)**

Local improvement districts are a special-purpose funding mechanism created by local governments to fund improvements in specific areas which are smaller than the unit of government. LIDs can be created by cities, counties, port districts, water districts and other public entities. A road improvement district is the same as an LID except that it funds only road improvements in unincorporated areas.

Once created, the special district can assess the properties within its boundaries for the cost to develop an improvement such as a water main, sewer line or a street that directly benefits the

properties. The assessment is not a tax because it is not uniform on all classes of property within the jurisdiction's boundaries. The amount assessed must be demonstrably equivalent to the "special benefit" that accrues to the property in the form of an increase in value. LID and RID formation require special property appraisals before and after the improvement is built.

The income from property assessments is used to back special LID bonds and may be repaid in one lump sum or over time with interest. Voter approval is not required for LID formation, but the agreement of a majority of property owners must be obtained. LIDs and RIDs can also be initiated by a petition of property owners or by a developer who is a large property owner in an area. Property owners may also challenge LID formation. A district is automatically dissolved when any outstanding debt is retired.

LIDs and RIDs were once much more common than they are today. Some of the reasons include the relatively high implementation costs compared to the typical size of an improvement and increasing opposition to the use of property assessments, thus difficulty in achieving the necessary property owner support.

### **Transportation Benefit Districts**

Transportation benefit districts (TBDs) are quasi-municipal corporations with independent taxing authority, including the authority to impose property taxes and impact fees for transportation purposes. The creation of TBDs was first recommended by the 1986 Task Force on Economic Development and Transportation Issues. The Task Force was formed to develop methods to ensure improved responsiveness of highway programming in areas of rapid economic development. The TBD statute, passed by the Legislature in 1987, authorizes counties and cities to establish TBDs

*...for the purpose of acquiring, constructing, improving, providing, and funding a city street, county road, or state highway improvement within the district that is (1) consistent with state, regional, and local transportation plans, (2) necessitated by existing or reasonably foreseeable congestion levels attributable to economic growth, and (3) partially funded by local government or private developer contributions, or a combination of such contributions.*

A transportation benefit district may be entirely within the boundaries of a county or city or it may cross jurisdictional boundaries, in which case interlocal agreements among the jurisdictions must be developed. Establishment of a TBD requires a public hearing. The legislative authority sits as the governing body and must make provision for the district to be automatically dissolved when all debts of the district have been retired. A TBD has the following revenue authority options:

- single-year, voter approved, excess property tax levies;
- multi-year, voter approved, excess property tax levies used to fund general obligation bonds;
- the issuance of general obligation bonds;

- the formation of local improvement districts, and issuance of special assessment bonds or revenue bonds to fund the improvement;
- development (impact) fees related to the transportation project; and
- acceptance of gifts and donations.

TBDs have not been widely used in Washington. Reasons cited by local elected officials include: that TBDs mean the establishment of another layer of government; the need to seek voter approval (60%) for an excess property tax; and in cases where a TBD crosses jurisdictional boundaries, the necessity that an interlocal agreement be made to address the scope of work, taxing method and taxing level.

The one existing TBD in the state is the Point Roberts TBD, an unincorporated area in Whatcom County on Semiahmoo Bay. The Point Roberts TBD was formed so that Point Roberts could collect the one-cent gas tax available to cities bordering Canada.

### ***Other Attempts to Form TBDs***

In the 1980s the South [King] County Area Transportation Benefit District (SCATBD – know as "Skateboard") was proposed by a number of cities in south King County (Renton, Tukwila, Auburn, Kent, SeaTac, Burien, Federal Way and others). The TBD was to be formed and approved by King County since the area within the district included unincorporated as well as incorporated areas. The member cities all passed resolutions supporting the district as required by King County. However, due to a number of circumstances – the additional layer of government the TBD required, the passage of the 1990 transportation revenue package by the state, and some opposition to the financing method (property tax) – the TBD was not approved. (SCATBD exists today as the South County Area Transportation Board but has no revenue authority).

Another TBD, the Ford's Prairie TBD in Lewis County was formed in 1990 to address transportation needs as a result of the January 1990 Chehalis River flood. Two separate ballot measures failed to secure the 60% voter approval needed to sell the G.O. bonds.

During the 1999 legislative session, a city-initiated bill, SB 5605, attempted to use the TBD as a mechanism for cities to collect the local option vehicle license fee (VLF) if the \$15 fee had not been imposed by the county in which the TBD is located. (The VLF is a 1990 local option granted to counties but used by only four counties to date.) Cities felt the TBD mechanism granted some nexus to the VLF.

### **Tax Increment Financing**

Tax increment financing (TIF) is a method of allocating a portion of property taxes in a certain area or "district" to finance economic development or capital improvements. Typically, in using tax increment financing, a local government or quasi-municipal corporation issues bonds to finance public improvements in a specified area or special district. The public improvements attract outside investment, causing the property values within the district to rise over time, which

in turn increases property tax collections. The difference between the existing property tax collections in the district and the higher property tax collections – the increment – is used to pay off the bonds. Many states' urban renewal programs are based on tax increment financing.

According to the National Conference of State Legislatures, tax increment financing is statutorily authorized in 46 states, including Washington. In fact, Washington does statutorily authorize tax increment financing, but it violates the State Constitution, making TIF unusable in Washington. An amendment to the state Constitution would be necessary to avoid violating the uniformity clause which says that taxes must be uniform upon the same class of property within the limits of the authority levying the tax.

Tax increment financing is similar to the LID mechanism except that the courts have found that an LID assessment is not a tax (therefore the uniformity clause issue which applies in tax increment financing does not apply). LID property owners are specifically assessed the value added to their property in exchange for the special benefit created by the improvement. In a TIF improvement, it is not an assessment but rather a general property tax that is used.

In Washington, tax increment financing was placed on the statewide ballot in 1973 and failed by more than a 2-to-1 margin. In 1982, it was placed on the ballot again and failed by a 69% no vote. However, the 1982 legislature statutorily authorized tax increment financing as "The Community Redevelopment Financing Act," and it remains in statute today. In 1985, a third constitutional amendment authorizing TIF was placed on the ballot and failed by 59% negative vote.

In 1995, The Washington Supreme Court invalidated the City of Spokane's use of the 1982 Community Redevelopment Financing Act. Spokane had attempted to use the Act to redevelop an area in downtown Spokane.

Recently, the City of Tacoma proposed a change to the TIF statute and sought state legislative approval of what is now known as the Community Revitalization Act. The 1999 version of Tacoma's proposal authorized a portion of the incremental *sales tax and business and occupation taxes* in the apportionment district to be used to finance a community revitalization project, thus avoiding the constitutional issue. Since this legislation would divert revenue intended for the state, the legislation capped the allocation at \$1 million per project and \$4 million annually statewide. The proposed legislation was not approved.

Oregon has made widespread use of TIF, with more than 40 cities and counties currently operating urban renewal districts. The City of Portland's urban renewal agency, the Portland Development Commission (PDC) has used 18 urban renewal districts since 1960. Transportation improvements have been a regular component of PDC districts; for example, the current North Macadam District plan calls for fully 35% of the TIF revenue in the district to be spent on transportation improvements, including extension of Portland's light rail transit service.

### **Toll Road/Toll Bridge Authority**

Washington State has a long legislative history of toll bridge construction. Most of the statutes governing toll facilities date back to establishment of the Toll Bridge Authority in 1937. The original Toll Bridge Authority funded, owned, operated and maintained facilities such as the Hood Canal Bridge and the Evergreen Point Floating Bridge. Through the years, there have been many amendments to the toll setting statutes.

Most of the powers and responsibilities concerning toll structures were transferred from the Toll Bridge Authority to the Department of Transportation when it was formed in 1977. The authority to set tolls for bridges, tunnels, ferries and other toll facilities was given to the Washington State Transportation Commission at that time. WSDOT was granted the ownership, operation and maintenance of the physical facilities. Those powers exist to this day.

WSDOT is empowered to issue bonds for the construction of toll bridges. All such bonds must be issued in the name of the department, be obligations of the department only, be secured by tolls, and do not constitute a debt or obligation of the State of Washington. However, before the department could expend any proceeds from bonds, appropriation must be made by the Legislature. Before authorizing a toll bridge, WSDOT is required to determine the need and practicality of any toll project as well as the feasibility of financing. The Transportation Commission has the power to set tolls, finance, refinance, and fiscally manage all toll facilities.

With one exception, WSDOT and the Commission have not used the toll setting authority granted to them since 1977. The exception is the periodic adjustment of ferry tolls by the Transportation Commission. Ferry tolls (fees) have been entirely dedicated to the operation and maintenance of ferry service and have not been used for construction of new ferry boats or ferry facilities.

In 1993 the Legislature adopted the Public Private Initiatives (PPI) program, authorizing the use of tolls by private entities prepared to finance infrastructure in the state. Despite the benefits of the program, including the infusion of new non-public funds, and the speed and efficiencies to be gained by using private sector development techniques, public opposition to the PPI program has been considerable. Equity issues raised by opponents of the program have been the most significant arguments against the program. Such issues apply to the public use of tolls as well.

While turnpikes and toll bridges were widely used in earlier days in this country, today the case for their use seems much harder to make. A largely built-out transportation system like Washington's raises numerous issues about the rationale for using tolls to fund infrastructure.

- Is it appropriate to impose tolls to fund improvements on an existing bridge or roadway segment if citizens have already been paying transportation taxes to fund similar facilities?
- Is it fair to fund heavily traveled bridges or roads by tolls just because they are congested while leaving lightly traveled corridors to be funded by general transportation taxes?
- Is a rationale of using tolls to fund new facilities versus existing facilities an acceptable one?

- Are tolls equitable because they make users pay directly for the benefit of using a facility; or are tolls inequitable because they fall disproportionately on lower income users?

These are among the difficult policy considerations that are unresolved and that have created much of the recent opposition to proposed toll projects. More on the topic of tolls can be found in the discussion paper, *Market Mechanisms and User Fees in Funding Transportation*.

### **63-20 Financing and Industrial Development Bonds**

The 63-20 financing mechanism is authorized by the federal Internal Revenue Service code. It is a public financing mechanism predicated on the creation of a non-profit entity somewhat like a public development authority and a long term revenue stream that can be used to back revenue bonds or industrial revenue bonds. The 63-20 mechanism is often used for facilities built as part of a public-private redevelopment, where private development techniques and public, tax-exempt financing can be leveraged to meet the interests of both sectors. Parking structures are an example of a good candidate for this kind of financing as the parking revenues can be a strong revenue stream to back the issuance of bonds. Private capital backing the bonds is also a feasible approach and can be appropriate for a roadway or interchange in support of a private development that creates jobs or other significant public benefit.

Industrial development bonds (IDBs) are a specific type of bond created by the federal government and favored with a tax-exempt interest rate generally lower than that of revenue bonds. States have a limited number of IDBs to issue each year, as authorized by Congress, and determine their allocation based on criteria of benefit to the public.

## **POTENTIAL SOLUTIONS**

**LID/RID.** LIDs and RIDs currently have a property assessment based on property value as the only allowed funding mechanism. Such assessments are added to a property owner's tax bill and look to the user like an increase in the property tax. A potential solution would be to seek legislative approval of assessment options other than property assessments. See below under TBDs for examples.

**Transportation Benefit Districts.** TBDs currently may use voter approved property taxes, LID assessments, developer fees or gifts. Like the LID/RID assessment, the allowable property tax is based on property value and is collected on the owner's property tax bill. One potential change that might be more acceptable to the public is creating a linkage to use of the transportation network by imposing the charge on automobile owners rather than property owners. Thus every vehicle registered within the boundaries of the district would be assessed a surcharge for transportation purposes. This charge would create some administrative challenges (e.g., identifying vehicles registered in the district).

A similar rationale was employed recently by a proposal of the Association of Washington Cities to allow a TBD within or coexistent with a city's boundaries to impose the \$15 vehicle license



fee (VLF) if it had not been imposed by the county. The State Department of Licensing was charged with determining the location of vehicle registrations.

Another option might be a flat fee such as the one authorized by the City Street Utility legislation which allows \$2 per month per residence or \$24 per year to be imposed. While the Washington State Supreme Court declared the previously existing method of assessing the charge unconstitutional, another option such as charging the vehicle owner might pass legal muster. It would still be necessary to identify specific transportation projects that would be funded directly by the “utility fee” or the surcharge, but this could be a selling point as the public would be able to see the charge as a user fee for certain transportation improvements.

**Tax Increment Financing.** Similar to LIDs/RIDs and TBDs, tax increment financing traditionally relies on the property tax. This is a handicap both because of the constitutional limitation and because of the low level of public support for any increases in the property tax. It would be useful to continue to pursue options such as the one proposed in 1999 by the City of Tacoma which would authorize use of a portion of the incremental sales tax and B&O tax in the apportionment district. It avoids the constitutional issue that arises with the property tax, since sales and B&O taxes are not subject to the uniformity clause.

Since this legislation would divert sales tax revenue intended for the state, the legislation capped the allocation at \$1 million per project and \$4 million annually statewide. An alternative that might be more acceptable to the Legislature might capture only the local share of the sales tax, not the 6.5-cent state share.

**Toll Road/Toll Bridge Authority.** To reintroduce the widespread use of tolls on public roads or bridges would likely require development of a policy rationale that is consistent and fair to all classes of projects and users and that can garner public support. Many members of the public are supportive of the concept of user fees and are familiar with tolls from other parts of the country, but re-implementation in Washington State has been controversial. Developing a sound policy basis for their use would be an important first step.